United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

To be argued by:
James P. Shanahan

Docket No. 74-2379

IN THE

United States Court of Appeals

For the Second Circuit

UNITED STATES OF AMERICA,

Appellee,

—v.—

HARRY F. HART,

Appellant.

On Appeal From The United States District Court
For The Northern District of New York

BRIEF FOR APPELLANT

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STATEMENT OF THE CASE

Harry F. Hart appeals from a judgment of conviction entered against him on June 18, 1974 in the United States District Court for the Northern District of New York whereby he was sentenced to an institution designated by the Attorney General for a period of three months on each of three counts to run concurrently and to pay a fine totaling $2,000. Execution of the jail sentence is stayed pending appeal as is the fine in that the condition imposed by the Court that the $2,000 be deposited in the Registry of the Court was met.

The case was tried before Hon. James T. Foley, Chief Judge and a jury. Mr. Hart was convicted on all counts of a three count indictment which charged him with wilfully and knowingly attempting to evade and defeat a large part of the income tax due

and owing by him and his wife for the years 1966-1968 by filing false and fraudulent joint income tax returns for each of the three years. Mrs. Hart was not charged in the indictment.

Mr. Hart moved before trial to suppress numerous oral statements made by him and a substantial number of documents which he turned over initially to a Tax Technician and subsequently to a Special Agent of the Internal Revenue Service. A suppression hearing was held before Judge Foley on March 21, 1974 immediately prior to the trial and the motion was denied (appendix pp. 103-106). Judge Foley advised Mr. Hart of his right to an exception (Supp. Hearing p. 106). The issue on appeal is whether, based on the facts in this case as developed by the hearing and the trial itself the District Court should have granted the motion to suppress the evidence obtained by the Agents from Mr. Hart.

STATEMENT OF FACTS

On December 31, 1968, Tax Technician David T. Smith was assigned to examine the 1967 income tax return of "H.F. & F.E. Hart" (Gov. Exhibit 1-2 p. 12) to be sure they are correctly filed and are accurate. (Trial trans. p. 205) Mr. Smith met with Mr. Hart on January 30, 1969 for 6 hours (Gov. Exhibit 1-2 p. 12) as the result of sending Mr. Hart an appointment letter to come to the office with his appropriate business records. He met with Mr. Hart six times (Trial trans. pp. 205 & 206; Exhibit 1-2 p. 12). At the first meeting he added the receipts in his receipt book to reconcile them to the return. Individual entries in the receipt book did not add up to the total receipts listed on the return. There was no explanation as to the differences, and he told Mr. Hart a more detailed analysis would be necessary, and he asked him to bring his bank statements and cancelled checks to the office. (Trial trans. p. 206). The Tax Technician analyzed his bank deposits and business expenses paid by check and by cash, and there appeared to be an understatement of income, that the income was not fully reported on the return. (Trial trans. p. 206). He then contacted Mr. Hart on February 11, 1969 and he asked

Mr. Hart if there was any explanation for the difference and he said there was none. He told Mr. Hart that it would be necessary to audit the previous year 1966 and he (Mr. Hart) brought his copy of the '66 return and the records for that year to the office presumably on April 19, 1969 (Gov. Ex. 1-2 p. 12) and Mr. Smith found ". . . a similar understatement of income". (Trial trans. p. 207). The approximate amount was ". . . 15 to 20 thousand dollars as to each year". (Trial trans. p. 208). The next interview apparently took place on June 13, 1969 at which time Mr. Smith told Mr. Hart that he would have no further contact with him. On June 24, 1969 Mr. Smith discussed the returns with Special Agent Duchna presumably as the result of a referral letter to the Intelligence Division.

Mr. Smith then assisted Mr. Duchna and met with Mr. Hart "a number of times . . . about 15 times". (Trial trans. p. 215).

On June 23, 1969 Special Agent Joseph A. Duchna was assigned to the case (Trial trans. p. 223) and he and Mr. Smith met Mr. Hart on September 16, 1969 at the Internal Revenue Office in Glens Falls, New York. He exhibited his credentials, told Mr. Hart that he was a Special Agent from the Intelligence Division and advised him of the function of a Special Agent. Mr. Duchna then advised him of his Constitutional Rights. (Trial trans. pp. 224-226). The Memorandum of Interview was received in evidence as Defendant's Exhibit A at the suppression hearing on March 21, 1974 and is part of this record.

POINT I

AS A MATTER OF FUNDAMENTAL FAIRNESS THE UNITED STATES GOVERNMENT SHOULD SET FORTH ON THE FACE OF ALL TAX RETURNS THE APPROPRIATE LANGUAGE RELATIVE TO THE PERTINENT SECTIONS OF THE INTERNAL REVENUE CODE WHICH COULD BE VIOLATED BY EVASION, FALSE STATEMENTS, OR FRAUDULENT RETURNS AND THE CRIMINAL PENALTIES RELATED TO SUCH ACTS.

An analysis of the pertinent sections of the Internal Revenue Code (26 USC 7201), (evasion) 7202 (collect or account) 7203 (records) and 7206 (declaration under the penalties of perjury) reveals that the penalties are potentially more severe than the average person (including accountants and attorneys) might expect upon reading the present statement (warning) set forth on the face of Mr. Hart's 1966, 1967 and 1968 returns which is as follows:

> "Under the penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct and complete. If prepared by a person other than taxpayer, his declaration is based on all information of which he had knowledge." (see trial trans. p. 982).

IT IS SUBMITTED THAT IT SHOULD STATE:

> "I declare that I have examined this return including accompanying schedules and statements and to the best of my knowledge and belief it is true, correct and complete. If it is not correct I recognize that I could be guilty of a felony and upon conviction could be fined not more than $5,000 — $10,000 and imprisoned not more than 3-5 years or both (depending on the offense) together with the costs of prosecution. If prepared by a person other than taxpayer, his declaration is based on all information of which he has knowledge".

Case law tells us that the established procedures of the Internal Revenue Service as regards audits and investigations are seldom if ever in a custodial setting nor are they necessarily

compelling unless a taxpayer refused to cooperate. ("I thought we had all good friendly meetings") (Supp. H. Trans. p. 69). However neither the Tax Technician, Mr. Smith nor the Special Agent Mr. Duchna ever said anything about fraud (Mr. Steiner, trial counsel's questions to Mr. Hart:)

> Q. During that time and all through this, were you advised even once that you were under investigation for criminal fraud?"
>
> A. No, I never was, No Sir, if I was, I would have had a lawyer. My understanding was it was just an investigation that's all, that's all I thought it was." (Supp. Hearing trans. p. 28)
>
> Q. And did he tell you that the purpose of the Intelligence Division was to look into possible fraud in income tax cases?"
>
> A. He never said anything about fraud, no Sir. (Supp. Hearing Trans. p. 70)

The logic seems to be that if a man does not know what is going on — don't tell him that he may have a problem. Why should this be an issue? Why shouldn't every American know specifically what the laws and penalties are in relation to tax violations? The 1040 return form is modified or changed in some way virtually every year. Why must we look solely to *Miranda* v. *Arizona* 384 U.S. 436 in relation to this type of an offense, and then not apply it?

The Courts have almost uniformly held that *Miranda* warnings are not required unless there is custody or compelling pressures. Yet the Internal Revenue Service as a matter of policy on November 26, 1968 announced a revised procedure for advising a taxpayer of his rights during an investigation conducted by a Special Agent of the Internal Revenue Service Intelligence Division. I.R.S. News Release IR-897 See *Cohen* v. *U.S.* 405 F2d 34 at p. 39 (8th Cir. 1968). Why not be sure at the outset (at the time of filing the return and at the first contact with the taxpayer at a field or office audit) that he the taxpayer knows what problems he might encounter? Present him with his return (with penalties set forth) or have him present it to the Internal Revenue Service Official and have the Tax Technician

refresh his recollection as to what is or may be involved. At that point and thereafter *Miranda* warnings might not even be necessary. But it was surely necessary that Mr. Hart not be taken advantage of. Or that he not be "compelled" to react the way he did.

Mr. Hart filed his 1966 tax return on May 26, 1967, his 1967 return was filed on July 12, 1968 and his 1968 return was filed on June 6, 1969. (Gov. Ex. 1-4 — Certificates of Assessments and Payments). All three were filed late which by itself is not significant in that extensions were undoubtedly requested. But these filings together with the key entries on his 1040 Form certainly were the basis for the audit. When Tax Technician Smith was assigned the return on December 31, 1968 he undoubtedly checked $212,755.08 Gross receipts (Item 1, Schedule C — p. 2) $7,998.75 business income (Item 4, p. 2 and Item 6 p. 1) and $885.78 Tax (Item 12 p. 1) $58,039. Salaries and wages (Item 15 p. 2) all from Gov. Ex. 1-2); (Also see Gov. Exhibits 7-15, 14 and 16. Presumably this was done prior to his first meeting with the taxpayer although his Activity Record does not reflect it. (p. 12 Gov. Ex. 1-2). An analysis of Gov. Exhibit 1-4 p. 1 indicates an overpayment of $1,088.22 for 1966 and Exhibit 1-1 shows a loss on $199,069 of gross receipts of $6,749.04. An analysis of Employers Quarterly Federal Tax Return (Gov. Ex. 7-15) shows an increase in Total Wages and Tips Subject to Withholding Plus Other compensation (line 1 top of pp. 1-3-5-7) in the amounts of $15,185; $13,573; $15,995 and $16,050. although Exhibits 7-15-16-17 are "Your Copy" (presumably the taxpayer's copies). The Internal Revenue Service undoubtedly had ready access to the filed copies. There is no reference to a preliminary or pre-audit procedure set forth in Mr. Smith's Activity Record (p. 12 Gov. Ex. 1-2) nor is there any reference to such a procedure in the *Internal Revenue Manual — Part IV Audit and Investigation* Vol. 1 published by the Tax Analysts and Advocates. However Revenue Agent George I. Kowitt, of the Syracuse, New York Internal Revenue Service Office stated in answer to my questions on page 118 of Appellant's Appendix *United States of America* v. *Caiello* 420 F2d 471 in relation to Mr. Caiello's audit:

Q. Now Sir, did there come a time when you were assigned to the investigation or the examination of the income tax returns of Richard V. and Patricia A. Caiello?

A. Yes, the case was assigned to me on April 27, 1964.

Q. Now Sir, what did you do upon receiving the assignment?

A. On June 1st of 1964 *I did my preliminary or pre-audit examination* (emphasis added). I then contacted Mr. Caiello by telephone and asked for an appointment *to examine his 1961 and 1962* (emphasis added) Federal Income Tax returns which had been assigned to me.

The Internal Revenue Service has access to a wealth of information conerning the taxpayer. His name, reputation in the community as well as the nature and extent of his business activities (Tax Technician or Revenue Agents own personal knowledge), information from third parties including the various agencies of the United States Government *Internal Revenue Manual — Part IV Audit and Investigation* Vol. 1 *Requests for Information from Third Parties;* Secs. 4082 through 4084.3; trade magazines including statistical accountings of cost to sales in the bar and restaurant business (U.S. Department of Labor; *Beverage Media* New York's Foremost Liquor and Beer Publication (Associated Beverage Publications) and general information acquired by the Internal Revenue Service over the years. Again, this type of pre-audit research need be done only in relation to returns involving large amounts of money.

In addition the Service directs (although this directive contemplates *Factors to consider Before Issuance of Summons;* Sec. 4022.3 of Internal Revenue Manual — Part IV supra) that certain procedures be followed. The Regulation States:

(1) "Among the factors to consider before resorting to the issuance of the summons are:

(a) The securing of information desired through other means should be explored. For example financial and other data may be secured from the tax return or the information desired may be secured from other parties, such as banks, employer, etc., without use of a summons".

With all of this information available and to be used as a basis for the examination of Mr. Hart's returns, Tax Technician Smith at the conclusion of his preliminary or pre-audit examination should have contacted the Regional Counsel as required by Sec. 4022.4(1) of the Internal Revenue Manual Part IV supra or at least at that point when he asked Mr. Hart for an explanation in relation to business expenses for 1967. This is not to concede that a crime had been committed at any time by Mr. Hart but certainly the Internal Revenue Service Regulations provide for such a situation.

POINT II

TAX TECHNICIAN SMITH SHOULD HAVE ADVISED MR. HART AT THE INITIAL MEETING ON JANUARY 30, 1969 OR AT LEAST AT THE TIME HE REQUESTED MR. HART'S 1966 RETURN THAT IF IT IS ESTABLISHED THAT THE RETURNS WERE NOT CORRECT MR. HART COULD BE GUILTY OF A FELONY AND HE SHOULD ALSO HAVE ADVISED HIM OF THE POSSIBLE PENALTIES WHICH COULD RESULT.

Mr. Hart's account of the sequence of events related to the investigation is confusing at best. However he does state at page 21 of the suppression hearing transcript that:

> "I never had any idea of being tax evasive, these people never told me I was being investigated for fraud on the government."

Mr. Duchna did advise him of his rights but did he communicate with Mr. Hart? Tax Technician Smith made no attempt to communicate with Mr. Hart at least in relation to his Constitutional rights.

The cases previously before this Court and the Supreme Court decisions since 1966 clearly set forth that there is no reason to advise a taxpayer of his rights unless the government compels a

person to incriminate himself *Miranda* v. *Arizona* supra; *Mathis* v. *United States* 391 U.S. 1; *U.S.* v. *Squeri* 398 F2d 785, 789-90 (2nd Cir. 1968). *United States* v. *Mackiewicz* 401 F2d 219, 222-3 (2nd Cir. 1968) *U.S.* v. *Caiello* 420 F2d 471. Mr. Hart consistently states that he freely gave the Revenue Agent and the Special Agent everything they asked for (suppression hearing transcript; p. 14 ". . . you got them all together and brought them right there? Yes Sir up to the Revenue office in Glens Falls) (p. 14-9) ". . . so I dug everything I had down in the cellar and I brought up my daily books and all my papers and everything I had." (p. 15) Mr. Hart cooperated during the whole investigation (trial trans. p. 669). Two Document receipts were signed for by Mr. Hart however they were presented to him by Special Agent Duchna (Gov. Ex. 1 and 2 received at p. 86 Supp. Hearing).

The Supreme Court in *Couch* v. *United States* 409 U.S. 328 states (in relation to the use of summons in investigating what may prove to be criminal conduct) in quoting *Donaldson* v. *United States* 400 U.S. 517.

> "To draw the line where a special agent appears would require the service in a situation of suspected but undetermined fraud, to forego either the use of the summons or the potentiality of an ultimate recommendation for prosecution. We refuse to draw the line and thus stultify enforcement of federal law.

It is submitted that Mr. Hart should have been advised at the time Mr. Smith added up the receipts at the initial interview of his constitutional rights. The Federal Government should be required to communicate with the American people. Mr. Hart should be entitled to know what possible penalties were involved and the Tax Technician and the Internal Revenue Service should be required to determine if Mr. Hart understood what was involved. Then if Mr. Hart decided that he wished to proceed fine!

The objective norm of wilfullness is based on whether or not Mr. Hart voluntarily turned over his books and records to the Tax Technician. It is entirely possible that Mr. Hart didn't know

any better. Each case must be looked at on an individual basis. The Internal Revenue Service has for several years advised the American taxpayer of the possibility of perjury on the face of the return presumably on the broad basis that it is possible to prove the falsity of the return. The Service is advising the taxpayer of the possibility of perjury but does not advise him of what perjury is or what the penalties are. It is presumably advising the taxpayer as to what might be proven against him but not what specific crimes he might be guilty of given a certain set of facts. In *U.S.* v. *Hoover* 233 F2d 870 the Court held that the signing and tendering of a false return constitutes a violation of Section 7201. Isn't the Internal Revenue Service advising him that he might be guilty of violating Sec. 7206 only on its return? And it obviously is not advising him of the possible penalties involved.

In *United States* v. *Caiello* supra at p. 473 Chief Judge Lumbard stated:

> The substance of our prior discussions is that if the taxpayer is aware that he is the subject of a tax investigation and if he is interviewed in noncustodial situations, *Miranda* warings are not required. The rationale is that once the taxpayer is aware that agents of the IRS are conducting a serious inquiry into his income tax liability and the agents do not conduct their investigation in a manner which is inherently coercive it is not improper to expect that to some extent persons must be prepared to look after themselves. *Morgan* v. *United States* 377 F2d 507, 508 1st Cir. 1967

Isn't there a question here of the subtleties of investigative technique? Shouldn't the taxpayer be made aware of what he may be subjected to? Shouldn't our Government serve the people and inform them of what crimes might be involved if for no other reason than to eliminate the question of whether the taxpayer knows or does not know the tax laws of the United States?

Does the mere fact that a taxpayer turns his papers over to the Internal Revenue Service mean that it was not a forcible or a compulsory extortion? *Boyd* v. *United States* 116 U.S. 616. The scope of the privilege is limited to the papers and effects which

are the private property of the person claiming the privilege or at least in his possession in a purely personal capacity. Mr. Hart should have been aware of the fact that he had this privilege – *United States* v. *White* 322 U.S. at 699. Certainly when the Tax Technician required that Mr. Hart provide him with his 1966 return after he examined Mr. Hart's 1967 return he should have sought assistance from his superiors and/or advised him of his constitutional rights. What else was he looking for? A pattern?

Everything in the Special Agent's Memorandum of Interview (Defendant's Exhibit A in evidence) was developed as the result of Mr. Smith having met with Mr. Hart, acquired all of his records after allegedly determining that there was, as the result of his initial audit of the 1967 return an understatement of expenses of $15,000 to $20,000. At some point Mr. Hart should have looked out for himself but subtlety rather than compulsion undoubtedly was the key.

In those cases where the taxpayer elects not to go forward he would have to have a very good personal reason (the percentage would be small). The Internal Revenue Service has access to all of the taxpayers tax records together with information which can be derived through investigation by the Special Agent from third parties and other sources generally. The Internal Revenue Service can prepare a case to present to the taxpayer for his response without much additional effort. In fact from a practical standpoint it might not take as long or be as complex as the present procedures which take years.

POINT III

CASES DISTINGUISHED.

On the basis of the procedures established by the Internal Revenue Service there is a distinction as to the nature of an audit. If the Tax Technician or the Revenue Officer is involved it is considered a Civil Audit. If a Special Agent becomes involved then there is a possible criminal matter. The Special Agent did not even testify in *U.S.* v. *Fahey*, Docket No. 74-8285 presently

pending before this Court. Isn't the Tax Technician to a great extent the Special Agent's agent? In *U.S.* v. *Ponder* 444 F2d 816, Louisiana Attorney Ponder agreed to supply all of his records to the Revenue Agents. This was determined by the Court to be a valid consent to search and a waiver of the Constitutional rights against self-incrimination. Mr. Hart, in contrast to Mr. Ponder is a sole proprietor with a sixth grade education, operating a restaurant-bar which specializes in Pizza. In *U.S.* v. *Prudden* 424 F2d 1021 the Revenue Agent, during the course of a civil audit detected fraud, referred the case to Intelligence, continued his examination and requested and received additional information and the information was not suppressed! That appears to be taking advantage of a taxpayer just to make an investigation less difficult and eliminates entirely the question of taxpayer's rights. However Mr. Prudden, an attorney was told the audit was not just routine. Mr. Hart was not advised that his audit was not just routine. If the Internal Revenue Service properly conducted its pre-audit investigation there would be little or no reason why the taxpayer could not be advised of what he is faced with. In *U.S.* v. *Sclafani* 265 F2d 408, a case which was tried by and cited by Judge Foley, this Court held

> "The Fourth Amendment does not require more than this, that when his consent is sought the taxpayer be apprised of the government's concern with the accuracy of his reports, *and therefore of such hazards as may be incident to a voluntary disclosure.* (emphasis supplied)
>
> We hold that Sclafani was so apprised by the warning inherent in the request when Agent Sonkin identified himself and disclosed his purpose to audit certain returns of the corporation".

A reading of the entire transcript (Mr. Hart's trial testimony has not been included in the Appendix) reveals that Mr. Hart seemingly did not know the hazards up to the date of sentencing. That is, he didn't know of the hazards to the extent of what he is now faced with. I'm not sure what the ordinary taxpayer is *Sclafani* supra at pp. 414-415. Mr. Hart doesn't seem to be. The Internal Revenue Service conducts periodic seminars for tax Preparers. Why not "instruct" each taxpayer when his 1040 is

mailed to him each year? In spite of the record ("I thought we had all good friendly meetings") (Mr. Hart; Supp. Trans. p. 69) is it not possible that Mr Hart ". . . was put in such an emotional state as to impair his capacity for rational judgement" *Escobedo* v. *Illinois*, 378 U.S. 478. And what about probable cause based on the selection and examination of the return together with the pre-audit examination. Isn't this combination compelling?

POINT IV

ALL OF THE RECORDS PROVIDED TO THE TAX TECHNICIAN DAVID T. SMITH AND STATEMENTS MADE TO MR. SMITH AND SUBSEQUENTLY TO MR. DUCHNA BY MR. HART SHOULD BE SUPPRESSED ON THE BASIS THAT MR. HART WAS NOT ADVISED OF THE POSSIBLE PENALTIES INVOLVED IF A CRIME WAS COMMITTED AT THE TIME OF FILING OF HIS TAX RETURNS AND OF HIS CONSTITUTIONAL RIGHTS AT THE POINT THAT IT WAS DETERMINED THAT THERE WAS AN UNDERSTATEMENT OF INCOME.

David T. Smith at the time of the audit was a Tax Technician. As such he examines individual income tax returns. He has audited between two and three thousand returns (trial trans. p. 205). The function of a Special Agent is to determine via a joint investigation with a Revenue Agent the correct tax liability, the possibility of income tax fraud and the imposition of tax fraud penalties, and the possibility of a recommendation of a criminal tax violation. *Couch* v. *United States* 409 U.S. p. 324; 93 S. Ct. 614. Wasn't it possible for Mr. Smith to either advise Mr. Hart or seek assistance at the point when he determined that there was an understatement? Shouldn't the law require him to do so? A man who has audited between two and three thousand returns obviously has a feel for the information contained in an individual tax return and an individual tax return chosen for audit with $212,755 in gross sales has to be something special.

POINT V

THIS PROCEDURE WOULD NOT BE UNDULY BURDENSOME TO THE INTERNAL REVENUE SERVICE IN THAT MOST TAXPAYERS WOULD GO FORWARD.

In a situation where a return is chosen for audit and the preliminary investigation and research is completed by the Tax Technician, there is no reason why, on a return by return basis in the case of an individual return, particularly where the income is considerable, a taxpayer cannot be advised of what might be involved (employees of Corporations and members of partnerships are not entitled to these Fifth Amendment Protections). (Corporation; *Wilson* v. *United States* 221 U.S. 361; Partnerships; *Bellis* v. *United States* 414 U.S. 911.) Under the present procedures only 1,128 tax evasion and related cases were prosecuted in fiscal year 1974. (Attorney General Saxbe before Associated Industries of New York State; October 4, 1974 at Lake Placid, New York) Mr. Smith's analysis of the expenses did not lead him to speculate nor would a candid discussion with Mr. Hart stultify enforcement of the Federal Tax Laws as stated in *Donaldson* v. *United States* supra. Mr. Hart may have gone forward. The Constitution of the United States requires that he be given that option.

CONCLUSION

THE MOTION TO SUPPRESS THE DOCUMENTS PRODUCED BY MR. HART AND HIS STATEMENTS MADE IN RELATION TO THESE RECORDS TO TAX TECHNICIAN SMITH AND SPECIAL AGENT DUCHNA SHOULD HAVE BEEN GRANTED. THE RECEIPT OF THIS EVIDENCE AT TRIAL SHOULD PROVIDE THE BASIS FOR A REVERSAL OF THE JUDGMENT OF CONVICTION AND AN ORDER GRANTING A NEW TRIAL SHOULD BE ISSUED.

Respectfully submitted,

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